# Union Budget 2011-12 Expectations

**Anantha Narayan**
anantha.narayan@icicisecurities.com
+91-22 6637 7311

**Koushik Rajagopalan**
koushik.rajagopalan@icicisecurities.com
+91-22 6637 7114

**I-Sec Equity Research**
i-sec.equityResearch@icicisecurities.com

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# Tightrope act: Populism versus fiscal discipline

- India's fiscal deficit position in FY11 will look impressive when compared to the expectations and even the Government's own estimates a year ago. As of December '10 (first 10 months of FY11), total receipts were 85% of FY11 estimates as against 64% in FY10. The total expenditure was broadly in line with the expectations. Fiscal deficit for the first 10 months of FY11 was 45% of FY11 estimates, far lower than 77% in FY10. However, this lower-than-expected fiscal deficit can be mainly ascribed to much higher-than-expected collections from the 3G and BWA spectrum auction, which was one-off in nature. Had the revenue from these auction been in line with expectations, rather than exceeding the expectations by a very wide margin, the total receipts for the first 10 months of FY11 would have been 75% (rather than 85%) and fiscal deficit 64% (rather than 45%) of FY11 estimates respectively.
- The Government, however, will have significant challenges cut out for FY12.
  - Receipts from the 3G and BWA spectrum auction (over Rs1,000bn and 15% of the total FY11 estimated receipts) were one-off in nature.
  - The Government has raised Rs228bn from disinvestment in public sector units in FY11 so far. Such proceeds depend on capital market conditions, which adds an element of uncertainty to these revenue sources.
  - Tax receipts may grow slower in FY12 if the overall earnings growth and the growth in economy slows down. Further, if FY12 growth gets skewed in favour of rural or agriculture-related segments, tax collections would be adversely affected given the various tax exemptions enjoyed by these segments.
  - Given the challenges the Government face, it becomes extremely imperative to control expenditure. However, with five states going for assembly elections this year (2011) with some more to go in 2012 and due to somewhat fragile political situation at present, there could be some temptation towards populism. Thus, the Government would be put to extreme tightrope walking – balancing between temptation for populism and the necessity to maintain the fiscal discipline.
- The good news from the market's perspective, in our view, is that the above-mentioned issues are well understood by the market and the expectations from the Budget are quite low among investors. This lessens the probability of any significant downside surprise if the Budget is not in keeping with the expectations.

# Budget highlights

| All figures (Rs bn) | FY09 (Est.) | FY09 (Act) | FY10 (Est.) | FY10 (Act) | FY11 (Est.) | FY11 (up to Dec '10) | As % of FY11 (Est.) | Same period in FY10 |
|---|---|---|---|---|---|---|---|---|
| Revenue receipts | 6,029 | 5,447 | 6,145 | 5,755 | 6,822 | 5,843 | 86 | 63 |
| Tax revenue (net) | 5,072 | 4,477 | 4,742 | 4,594 | 5,341 | 3,911 | 73 | 65 |
| Non-tax revenue | 958 | 969 | 1,403 | 1,160 | 1,481 | 1,931 | 130 | 58 |
| Non-debt capital receipts | 147 | 67 | 53 | 308 | 451 | 313 | 69 | 155 |
| Recovery of loans | 45 | 62 | 42 | 62 | 51 | 86 | 168 | 94 |
| Other receipts | 102 | 5 | 11 | 246 | 400 | 227 | 57 | 385 |
| Total receipts (1+4) | 6,176 | 5,514 | 6198 | 6,062 | 7,273 | 6,156 | 85 | 64 |

Source: CGA, India budget documents, Mospi, CSO, I-Sec Research

- FY11 tax collections were aided by strong economic growth; any slowdown could impact the growth of tax revenue
- Collections from the 3G and BWA spectrum auction (over Rs1,000bn) were one- off in nature

| All figures (Rs bn) | FY09 (Est.) | FY09 (Act) | FY10 (Est.) | FY10 (Act) | FY11 (Est.) | FY11 (up to Dec '10) | As % of FY11 (Est.) | Same period in FY10 |
|---|---|---|---|---|---|---|---|---|
| Non-plan expenditure | 5,075 | 6,060 | 6,957 | 7,163 | 7,357 | 5,369 | 73 | 72 |
| On revenue account | 4,484 | 5,565 | 6,188 | 6,542 | 6,436 | 4,877 | 76 | 75 |
| On capital account | 591 | 495 | 769 | 621 | 921 | 492 | 54 | 47 |
| Plan expenditure | 2,434 | 2,755 | 3,251 | 3,022 | 3,731 | 2,500 | 67 | 65 |
| On revenue account | 2,098 | 2,352 | 2,784 | 2,538 | 3,151 | 2,129 | 68 | 65 |
| On capital account | 336 | 403 | 468 | 484 | 580 | 371 | 64 | 66 |
| Total expenditure | 7,509 | 8,815 | 10,208 | 10,185 | 11,087 | 7,869 | 71 | 69 |
| Fiscal deficit | 1,333 | 3,301 | 4,010 | 4,123 | 3,814 | 1,712 | 45 | 77 |
| Net fiscal deficit as % of GDP | | | | 6.9 | 5.5 | | | |

Source: CGA, India budget documents, Mospi, CSO, I-Sec Research

- Temptation towards populism and increase in outlay for schemes such as NREGS make expenditure control a challenge
- While FY11 fiscal deficit target will be easily beaten, it will be difficult to meet the target of 4.8% and 4.1% for FY12 and FY13 respectively that the government had set earlier

# Sector wise budget expectations and likely impact

| Sector | Key measures | Likely impact |
|---|---|---|
| Auto | ● There is talk of increasing the excise duty given the strong growth and imposing some form of tax on the sale of diesel passenger cars. This could have a negative impact on Tata Motors given that it has the strongest diesel car portfolio. However, as the government has generated higher revenue despite a lower excise duty regime, it could decide against such a hike. | Sector – Neutral to Negative<br>Gainers – None<br>Losers – Tata Motors |
| Banks | ● Banks may be allowed to raise funds through infrastructure bonds, which will be negative for PFC, REC and IDFC.<br>● Allocation of capital for infusion into PSU banks will be a positive for banks with low government holding.<br>● Creation of a grant/subsidy/facility/roadmap to address the problem of rising SEB losses will be positive for REC, PFC and large PSU banks.<br>● Raising limit of refinancing from IIFCL for commercial banks will be a positive.<br>● A key number to watch out for will be the extent of government borrowings – High/low gross borrowings could be negative/positive for yields and for banks. | Sector – The level of government borrowings if significantly above that of the last year could pressurise yields and interest rates, thereby negatively impacting bank stocks.<br>Gainers – SBI (if any clarity emerges on the rights issue), Axis Bank, PSU banks with government holding of about 51% and banks with high infra exposure like SBI, Axis,Bank and Canara Bank (if infra bonds are allowed).<br>Losers – PFC/REC/IDFC (if infrastructure bonds become available to banks) and PSU banks depending on the overall level of borrowings. |

# Sector wise budget expectations (contd…)

| Sector | Key measures | Likely impact |
|---|---|---|
| Cement | • Increased thrust on infrastructure with specific guidelines for implementation will be positive for the sector.<br>• Excise duty is unlikely to be increased considering the current concerns on high inflation. | Sector – Neutral<br>Gainers – None<br>Losers – None |
| Fertiliser | • Budgetary provisions for fertiliser subsidies may be reduced in the light of increasing fiscal deficit and/or a price hike could be implemented to reduce the subsidies.<br>• Under-provisioning of fertiliser subsidies has caused payment delays in FY11 that should be addressed in the FY12 Budget. | Sector – Neutral<br>Gainers – Urea fixed subsidy increase would be positive for Chambal and Nagarjuna.<br>Losers – Lower subsidy provisioning would indicate pressure on P&K segment as the government has reduced subsidy for FY12 and the industry is hoping for an upward subsidy revision. |
| FMCG | • Excise duty on cigarettes – after a 15% increase in the effective excise rate in the last Budget, we believe the excise duty on cigarettes may remain unchanged this Budget. | Sector – Positive<br>Gainers – ITC<br>Losers – None |

# Sector wise budget expectations (contd…)

| Sector | Key measures | Likely impact |
|---|---|---|
| Infrastructure | ● Any initiative to develop a corpus for long-term funds to be utilised towards infrastructure development (the most recent example being tax-saving infra bonds) will be positive for the sector.<br>● Setting up of an agency to take care of fast track clearance of infrastructure projects will quicken the pace of execution.<br>● Budgetary support to Indian Railways will help companies such as Texmaco. | Sector – Positive<br>Gainers – All infrastructure companies and Texmaco<br>Losers – None |
| Media | ● Reduction in duty on set-top boxes is likely and this will be positive for cable and DTH companies | Sector – Positive<br>Gainers – Dish TV and Hathway Cable<br>Losers – None |
| Metals | ● Any reduction in the 5% import duty on thermal coal and continuation of existing zero import duty on coking coal would be beneficial for Hindustan Zinc as well as steel players.<br>● An increase in the import duty on hot rolled coils from the existing 5% to 10% or above to encourage the growth of domestic steel industry will have positive impact on JSW Steel and Tata Steel. | Sector – Positive<br>Gainers – Hindustan Zinc, JSW Steel and Tata Steel<br>Losers – None |

# Sector wise budget expectations (contd…)

| Sector | Key measures | Likely impact |
|---|---|---|
| Real estate | ● An increase in tax exemption limit on interest and principal payments on home loans and rental income is possible.<br>● The Government could consider tax holiday benefits under Section 80IB (10) for affordable housing projects.<br>● Providing more incentives to real estate mutual funds (REMFs) to support the housing sector will be a beneficial move for the sector. | Sector – Positive<br>Gainers – All real estate companies<br>Losers – None |
| Oil & Gas | ● Income Tax holiday for natural gas: Oil & Gas E&P companies expect the Government to restore the tax holiday for natural gas production retrospectively for all gas producing blocks. This would be specifically critical for new production coming up from KG basin fields, considering these blocks are deepwater and hence require higher capex. This can be done by including natural gas in the definition of mineral oil.<br>● Rationalisation of tax holiday for hydrocarbons: E&P operators could be permitted to select a continuous 10-year period for tax holiday at any time out of the first 15-year period following the commencement of commercial production. This logic is already accepted for other infrastructure projects such as power, roads, telecommunication, ports, airports and water supply that have similar large capex requirements.<br>● Reduction in customs and excise duty: The recent rise in under-recoveries has adversely impacted the financials of oil marketing companies (OMCs). In the FY 10-11 Budget, a 5% import duty on crude oil was imposed and the duty on petrol and diesel was increased to 7.5% from 2.5%. Also, the excise duty on petrol and diesel was increased by Rs1 per litre each, taking it to Rs14.35 and Rs4.60 a litre respectively. Reduction in these duties is a possibility in this Budget. | Sector – Positive<br>Gainers – RIL, ONGC and Cairn, and OMCs<br>Losers – None |

# Sector wise budget expectations (contd…)

| Sector | Key measures | Likely impact |
|---|---|---|
| Pharma | ● Weighted 200% tax deduction on R&D expenditure is expected to continue. Most companies benefit by this as R&D expenses constitute close to 6-8% of their revenue.<br>● Currently, an excise duty of 10% (plus 3% cess) is levied on inputs (active pharmaceutical ingredients or API) whereas the output is taxed at 4% (plus 3% cess). There could be a change in the structure to do away with this anomaly. Key beneficiaries from any such move would include large vertically integrated manufacturers such as Sun, Cipla, Dr Reddy's and Lupin.<br>● Physician samples could be exempted from payment of excise duty. Companies having a larger share of total revenue accruing from India such as Sun and Cipla would gain from such a move. | Sector – Positive to Neutral<br>Gainers – Sun, Cipla, Dr Reddy's and Lupin<br>Losers – None |
| Power | ● Benefit of section 80-IA (4) (iv) is likely to be extended for one more year till FY12 as the benefit expires at the end of FY11. Power generation, transmission & distribution companies get benefit of tax exemption under section 80-IA. Given the power deficit situation in India, the power sector remains a priority sector for attracting investment.<br>● MAT rate may not be revised up further. MAT rate has been increased for the past three years, causing higher tax payouts for tax-exempted companies.<br>● There could be increased allocation for APDRP and RGGVY as these schemes would increase efficiency and coverage.<br>● No levy of duty on imported power equipment is likely.<br>● Tax incentives for promoting indigenous power equipment manufacturing capacity are likely. | Sector – Positive<br>Gainers – Continuation of 80-IA is factored in; increased allocation to various schemes is positive for T&D companies and suppliers like PGCIL, Crompton, Jyoti and Kalpataru<br>Losers – None |

# Sector wise budget expectations (contd…)

| Sector | Key measures | Likely impact |
|---|---|---|
| Shipbuilding | ● Subsidy allocation (FY11 allocation was about Rs3.5bn) may be increased substantially as the Government intends to clear the dues in about three years (Rs49bn in total, including dues related to future deliveries). | Sector – Positive<br>Gainers – ABG Shipyard<br>Losers – None |
| Technology | ● Tax benefits under section 10A/10B are unlikely to be extended. However, since the Direct Tax Code is likely to be effective from FY13, the industry especially mid-sized IT companies are demanding extension of tax benefits for a year. | Sector – Neutral<br>Gainers – Mid cap IT companies (if tax benefits get extended)<br>Losers – None |
| Telecom | ● Extension of tax benefits under section 80-IA for the new licenses issued after March 31, '05 will be a positive.<br>● Relaxation of requirement for PAN card at the time of mobile connection can marginally aid new subscriber sign-up.<br>● Budgetary allocation for establishing a broadband network is likely, as per the proposal of the National Optical Fibre Agency, to cover the entire country at a cost of Rs600bn. | Sector – Positive<br>Gainers – New entrants and telecom equipment manufacturers<br>Losers – None |

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